Some US Tax Aspects of Home Ownership in Germany...

by Mark Christensen

Many members of the Kaiserslautern Military Community purchase a home while stationed here. Many factors influence the decision to buy a home in Germany, and tax obligations, savings, or expenses are as important as any other factor. This article provides some issues to consider when making the important financial decision whether to buy a home outside the United States.

An incentive to buy for many in the United States is that the US tax code permits homeowners to deduct home mortgage interest and property tax against income. The standard deduction afforded to single and married filers is often less than the mortgage interest and property tax paid out, so the deduction (especially when added to charitable contributions and unreimbursed medical expenses) can result in real tax savings to the average homeowner. This deduction is also available to US taxpayers who purchase homes outside the United States. Soldiers who receive the tax-free Overseas Housing Allowance can convert from Euros to dollars the amounts spent on home mortgage interest and property tax, and deduct those amounts from their gross income using Schedule A.

Civilians who receive the tax-free Living Quarters Allowance (LQA) can also deduct home mortgage interest and property tax paid on their primary home, but must reduce the deduction based on the amount of LQA received during the year. For instance, consider a civilian employee who receives LQA of $9,000 during the year, and paid home mortgage interest, property tax, and utility expenses of $10,000. The employee can deduct 10% of the paid home mortgage interest and property tax amounts, because 90% of those expenses were covered by a tax-free allowance.

Some who buy homes outside the United States do so with the intent of becoming a landlord, or may become a landlord because of a PCS move and a desire to retain ownership of the house. Just like being a landlord of a house in the US, the rental income must be reported on a tax return, and expenses associated with residential rental property are deductible on a US tax return. Using Schedule E, a landlord will report in dollars the rental income received, and deduct the expenses associated with the rental property. Deductible expenses include mortgage interest, management fees, property tax, utility assessments, cleaning, insurance, maintenance, and repairs. An important difference between US and non-US rental property is depreciation. US residential rental property is depreciated over 27.5 years (3.636% of the cost basis deducted each year). Residential rental property located outside the US may also be depreciated, but is done so over 40 years (2.5% of the cost basis deducted each year).

U.S. taxpayers who sell their primary home may be able to exclude up to $250,000 of the gain associated with the sale from their income. This exclusion applies to taxpayers who sell homes located outside the United States. To qualify for the exclusion the taxpayer must have owned and lived in the home for two of the previous five years. Married filing joint taxpayers can exclude up to $500,000 of gain. If the taxpayer ever had the property in rental prior to the sale they will be required to recapture the allowed (or allowable) depreciation for the rental period.

If you have questions about this or other income tax issue, put the question into the body of an e-mail and send it to tax@eur.army.mil. One of our tax attorneys will respond.